

**WO**

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF ARIZONA

City of Phoenix,

Plaintiff,

v.

First State Insurance Company; Twin City  
Fire Insurance Company; New England  
Reinsurance Corporation; Nutmeg  
Insurance Company,

Defendants.

No. CV-15-00511-PHX-NVW

**ORDER**

**TABLE OF CONTENTS**

I.	LEGAL STANDARD .....	1
II.	UNDISPUTED MATERIAL FACTS.....	2
A.	Asbestos lawsuit against the City .....	2
B.	The City's liability insurance .....	2
1.	The Hartford's excess policies .....	3
a.	Duty to indemnify against liability .....	3
b.	Duty to pay defense costs, but not to defend .....	4
2.	The Hartford's umbrella policies .....	5
a.	Duty to indemnify against liability and defense costs .....	6
b.	Duty to defend.....	8

1	C.	The City’s communication with The Hartford regarding the asbestos lawsuit .....	9
2			
3	III.	INTERPRETATION OF THE INSURANCE POLICIES .....	11
4	A.	Excess policies .....	12
5	1.	The Hartford has no duty to indemnify the City for any of the settlement. ....	12
6	2.	The Hartford has no duty to pay any of the City’s defense costs because the City settled within its retained limit. ....	14
7	3.	Alternatively, reimbursement of defense costs is allocated across policy periods and no year exceeds the City’s retained limit, however calculated. ....	18
8			
9			
10	B.	Umbrella policies .....	23
11	1.	The Hartford has no duty to indemnify the City for any of the settlement or defense costs in this case. ....	24
12	2.	The Hartford had no duty to provide a defense. ....	25
13			
14	IV.	BAD FAITH.....	27
15	A.	Processing of claim .....	28
16	B.	Denial of claim .....	29
17			
18	V.	EXPERT TESTIMONY .....	30
19	VI.	MOTION TO TRANSFER .....	33
20			
21			
22			
23			
24			
25			
26			
27			
28			

1 From 1981 to 1985, Defendants insured the City of Phoenix against liability for  
2 bodily injury occurring during that time. The insurance applied only to liability incurred  
3 above the City's \$500,000 self-insured retention. In 2013, a third party sued the City for  
4 bodily injury caused by asbestos exposure that occurred from 1967 to 1993. The City  
5 settled the lawsuit for \$500,000 and spent more than \$1,400,000 in defense costs.  
6 Defendants denied coverage for these expenses. The City claims Defendants violated  
7 their policy terms and acted in bad faith.

8 Before the Court are Defendants' Motion for Summary Judgment (Doc. 65), the  
9 City's competing Motion for Partial Summary Judgment (Doc. 68), and the parties' briefs  
10 and statements of facts. For the reasons explained in Parts I–IV below, Defendants'  
11 motion will be granted and the City's motion will be denied.

12 Also before the Court is Defendants' Motion to Exclude Expert Testimony of  
13 Jeffrey Stempel (Doc. 67) and the accompanying briefs. Although summary judgment  
14 does not depend on whether Stempel's testimony is admissible, Defendants' motion to  
15 exclude will be granted in part, as explained in Part V below.

16 Also before the Court is Defendants' Motion to Transfer Related Case (Doc. 78)  
17 and the accompanying briefs. For the reasons explained in Part VI below, the motion  
18 will be denied.

## 19 20 **I. LEGAL STANDARD**

21 Summary judgment is proper where there is no genuine dispute about a material  
22 fact. Fed. R. Civ. P. 56(a). A material fact is one that "might affect the outcome of the  
23 suit under the governing law." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248  
24 (1986). A genuine dispute of material fact exists where "the evidence is such that a  
25 reasonable jury could return a verdict for the nonmoving party." *Id.*

26 The movant has the burden of showing the absence of any genuine dispute of  
27 material fact. *Id.* at 256. If that burden is met, the nonmovant must set forth "specific  
28 facts showing that there is a genuine issue for trial." *Id.* In deciding a motion for

1 summary judgment, the Court must not weigh evidence or make credibility  
2 determinations, and must draw all justifiable inferences in the nonmovant's favor. *Id.* at  
3 255. Where the record, taken as a whole, could not lead a rational trier of fact to find for  
4 the nonmoving party, there is no genuine issue for trial. *Matsushita Elec. Indus. Co. v.*  
5 *Zenith Radio Corp.*, 475 U.S. 574, 586 (1986).

## 6 7 **II. UNDISPUTED MATERIAL FACTS**

8 The following facts are drawn from undisputed portions of the parties' statements  
9 of facts (Docs. 66, 69) and attachments thereto.

### 10 **A. Asbestos lawsuit against the City**

11 In April 2013, Carlos Tarazon served a Notice of Claim on the City of Phoenix,  
12 alleging he had developed cancer from working for the City with asbestos-laden pipes  
13 from 1967 to at least 1993. The Notice offered to settle Mr. Tarazon's claims against the  
14 City for \$10,500,000. After the offer expired, Mr. Tarazon died, and his surviving spouse  
15 sued the City and others in state court.

16 In November 2014, Ms. Tarazon renewed the \$10,500,000 settlement offer. Days  
17 later, she offered to settle for \$7,000,000 instead. In April 2015, the City and Ms.  
18 Tarazon agreed to settle for \$500,000. The City ultimately spent \$1,486,031.68 in  
19 attorney's fees and costs (collectively, "defense costs"), on top of the settlement payment.

### 20 **B. The City's liability insurance**

21 During the twenty-six years in which Mr. Tarazon was exposed to asbestos, the  
22 City was insured under a variety of policies. In the present lawsuit, the City seeks  
23 coverage only under policies in place during four of those years: from July 1, 1981 to  
24 July 1, 1985. Defendants, the issuers of those policies, are second- and third-tier  
25 subsidiaries of The Hartford Financial Services Group. (Doc. 5.) They will be  
26 individually and collectively referred to as "The Hartford."

27 The Hartford's policies insured the City against liability incurred above the City's  
28 \$500,000 self-insured retention. The self-insured retention was in place of prior primary

1 insurance.<sup>1</sup> The policies were of two types: excess policies and umbrella policies.  
 2 Excess policies were in place during all four years, and umbrella policies were in place  
 3 during three of those years. Although policy terms differed slightly from year to year, the  
 4 basic setup was the same. The policies in place during the first year are representative.  
 5 (Doc. 69-2 at 2–25; Doc. 69-3 at 28–45.)

### 6 **1. The Hartford’s excess policies**

7 Under the excess policies, The Hartford agreed to (1) indemnify the City against  
 8 liability incurred above \$500,000 but not above \$1,000,000 and (2) pay a share of the  
 9 City’s defense costs in cases where liability is adjusted for more than \$500,000.  
 10 Although The Hartford had a right to associate with the City at its own cost in the defense  
 11 of claims likely to exceed \$500,000, it had no duty to do so.

#### 12 **a. Duty to indemnify against liability**

13 According to the declarations page, the excess policies covered “excess liability”  
 14 above the City’s \$500,000 self-insured retention. (Doc. 69-2 at 2.) The self-insured  
 15 retention was referred to as the “retained limit.” (*Id.* at 3–4, 14.) In the basic insuring  
 16 clause, The Hartford agreed to indemnify the City for “ultimate net loss” due to bodily  
 17 injury liability in excess of the “retained limit”:

18 . . . [T]he [Hartford] agrees with the [City] and will indemnify  
 19 the [City] for ultimate net loss in excess of the retained limit  
 20 hereinafter stated which the [City] shall become legally  
 21 obligated to pay by reason of liability imposed by law, or  
 22 liability assumed by contract, insofar as the [City] may  
 legally do so for damages because of . . . bodily injury  
 liability . . . .

---

23  
 24 <sup>1</sup> The Hartford presents the Court with internal City documents so describing the  
 25 self-insured retention. (Doc. 66 at ¶¶ 21–38.) The City says these documents are  
 26 irrelevant to interpreting The Hartford’s policies because they are not evidence of the  
 27 parties’ mutual intent. (Doc. 75 at ¶¶ 21–38; Doc. 74 at 6–8.) Although these documents  
 28 are relevant in showing the City’s own intention to have the same rights and obligations  
 of a primary insurer, the Court need not consider the documents because that intention is  
 obvious from the terms and structure of The Hartford’s policies.

1 (*Id.* at 3.) “Ultimate net loss” meant settlements or judgments for which the City is  
 2 liable, including court-awarded fees and costs but excluding loss adjustment expenses:

3 “Ultimate Net Loss” means the sum actually paid or payable  
 4 in cash in the settlement or satisfaction of losses for which the  
 5 [City] is liable either by adjudication or compromise . . . and  
 6 includes attorney’s fees, court costs and interest on any  
 7 judgment or award, but excludes all loss adjustment expenses  
 and all salaries of employees and office expenses of the  
 [City], [The Hartford] or any underlying insurer so incurred.

8 (*Id.* at 10.)

9 Coverage extended to liability “caused by an occurrence, during the policy  
 10 period.” (*Id.* at 3.) “Occurrence” included “an accident, or event including continuous or  
 11 repeated exposure to conditions, which results during the policy term, in bodily injury.”  
 12 (*Id.* at 9.) Coverage was limited to \$500,000 above the retained limit. (*Id.* at 2, 14.) The  
 13 City paid a premium of \$132,060. (*Id.* at 2.)

14 **b. Duty to pay defense costs, but not to defend**

15 The excess policies contained a separate section titled “Defense, Settlement and  
 16 Supplementary Payments.” (Doc. 69-2 at 3.) This section gave The Hartford the right to  
 17 associate with the City in defending claims “reasonably likely” to involve The Hartford:

18 The [Hartford] shall have the right and opportunity to  
 19 associate with the [City] in the defense and control of any  
 20 claim or proceeding arising out of an occurrence reasonably  
 21 likely to involve [The Hartford]. In such event, the [City] and  
 [The Hartford] shall cooperate fully.

22 (*Id.*) It also prohibited the City from incurring costs on behalf of The Hartford without its  
 23 consent, which could not be unreasonably withheld, in defending claims that “appear  
 24 likely” to exceed the retained limit:

25 Should any occurrence appear likely to exceed the retained  
 26 limit, no loss expense or legal expense shall be incurred on  
 27 behalf of [The Hartford] without its prior consent. Such  
 28 consent shall not be unreasonably withheld.

1 (*Id.*)

2 The section also identified two circumstances governing The Hartford's duty to  
3 contribute to the City's defense costs. First, as to claims against the City that are  
4 "adjusted" for equal to or less than the retained limit, The Hartford would pay no defense  
5 costs:

6 Should any claim arising from such occurrence be adjusted  
7 prior to trial court judgment for a total amount not more than  
8 the retained limit, then no loss expenses or legal expenses  
shall be payable by [The Hartford].

9 (*Id.*) Second, as to claims against the City that "might be adjusted" for more than the  
10 retained limit, The Hartford would pay a share of defense costs in proportion to any  
11 liability incurred above the retained limit, with the caveat that the City would pay no  
12 more than the retained limit in defense costs:

13 However, should the total amount for which such claim might  
14 be adjusted prior to such judgment exceed the retained limit,  
15 then if [The Hartford] consents to further trial court  
16 proceedings, it shall contribute to legal expenses in the ratio  
17 which its proportion of the liability for the judgment  
18 rendered, or settlement made, bears to the whole amount of  
19 said judgment or settlement, however in no event shall the  
[City's] participation in such legal expenses exceed the  
retained limit . . . .

20 (*Id.*) Although The Hartford had a duty in some circumstances to reimburse the City for  
21 some costs spent in litigation, it never had a duty to participate in the defense of claims  
22 during litigation.

## 23 **2. The Hartford's umbrella policies**

24 Under the umbrella policies, The Hartford agreed to indemnify the City against  
25 liability and defense costs incurred above the excess policies' limit, as well as certain  
26 other liability and defense costs. The Hartford also had the option to provide a defense or  
27 leave it to the City to provide its own defense. Either way, the defense costs incurred by  
28

1 either the City or The Hartford were part of the ultimate net loss that The Hartford must  
2 indemnify up to the umbrella policies' limit.

3 **a. Duty to indemnify against liability and defense costs**

4 The umbrella policies insured the City in two ways. First, they added a layer of  
5 excess insurance, covering types of liability that fell within the scope of the excess  
6 policies but exceeded the excess policies' upper limit. For this reason, the declarations  
7 page contained a schedule of "Underlying Insurance Policies" that listed the excess  
8 policies' \$500,000 limit, which was itself "excess of" the City's \$500,000 self-insured  
9 retention. (Doc. 69-3 at 28.) Second, the umbrella policies covered types of liability that  
10 fell outside the scope of the excess policies but exceeded a smaller self-insured retention.  
11 For this reason, the declarations page listed a separate \$25,000 "self-insured retention."  
12 (*Id.*)

13 Dual coverage is typical of umbrella policies. "Umbrella policies differ from  
14 standard excess insurance policies in that they are designed to fill gaps in coverage both  
15 vertically (by providing excess coverage) and horizontally (by providing primary  
16 coverage)." *Commercial Union Ins. Co. v. Walbrook Ins. Co.*, 7 F.3d 1047, 1053 (1st  
17 Cir. 1993). Interpretive issues may relate to one type of coverage but not the other. *E.g.*,  
18 *Coleman Co. v. California Union Ins. Co.*, 960 F.2d 1529, 1530 n.1 (10th Cir. 1992)  
19 ("The issue before us relates solely to the excess component of the umbrella policy.").

20 Accordingly, in the basic insuring clause, The Hartford agreed to indemnify the  
21 City for "ultimate net loss" due to bodily injury in excess of "the underlying limit or the  
22 self-insured retention, whichever is the greater":

23 The [Hartford] will indemnify the [City] for ultimate net loss  
24 in excess of the underlying limit or the self-insured retention,  
25 whichever is the greater, because of . . . bodily injury . . . .

26 (*Id.* at 41.) The "underlying limit" was defined as the coverage limit of the excess  
27 policies. (*Id.* at 44.) The "self-insured retention" was defined as the amount listed on the  
28 declarations page and did not apply to types of liability covered by the excess policies.



(*Id.*) Thus, where the type of liability fell within the scope of the excess policies, the underlying limit of the excess policies (\$1,000,000) would be “the greater” and The Hartford would indemnify ultimate net loss above that amount. Conversely, in cases where the type of liability fell outside the scope of the excess policies, the separate self-insured retention (\$25,000) would be “the greater” and The Hartford would indemnify ultimate net loss above that amount. It is undisputed that the City’s asbestos liability fell within the scope of the excess policies (*see* Doc. 68 at 8), so this case involves The Hartford’s duty to indemnify loss above \$1,000,000. This case does not involve liability outside the scope of the excess policies, such as aircraft-related liability (*see* Doc. 69-2 at 5), as might trigger The Hartford’s duty to indemnify loss above \$25,000.

Unlike in the excess policies, “ultimate net loss” in the umbrella policies included not just settlements and judgments, but defense costs too:

“[U]ltimate net loss” means the total of the following amounts arising with respect to each occurrence to which this policy applies:

- (1) all sums which the [City], or any organization as [its] insurer, or both, shall become legally obligated to pay as damages, whether by reason of adjudication or settlement, because of bodily injury . . . , and
- (2) all expenses incurred by the [City] or [The Hartford] in the investigation, negotiation, settlement and defense of any claim or suit seeking such damages, excluding only the salaries of the [City’s] or [The Hartford’s] regular employees.

(Doc. 69-3 at 44.)

Coverage extended to liability “caused by an occurrence which takes place anywhere in the world.” (*Id.* at 41.) “Occurrence” meant “an accident, including continuous or repeated exposure to conditions, which results in bodily injury.” (*Id.* at 44.) The City paid a premium of \$21,053 for the first year. (*Id.* at 28.)

**b. Duty to defend**

The umbrella policies contained a separate section titled “Investigation, Defense, Settlement.” (*Id.* at 41.) The first sentence stated that The Hartford will defend claims against the City “to which this policy applies” and “which no underlying insurer is obligated to defend,” and if The Hartford did undertake the defense, it would control the defense and the settlement:

The [Hartford] will defend any claim or suit against the [City] seeking damages on account of injury or damage, to which this policy applies and which no underlying insurer is obligated to defend, but may make such investigation, defense and settlement thereof as it deems expedient . . . .

(*Id.*) But the second sentence allowed The Hartford to “elect[] not to . . . defend,” in which event the City must provide a defense under The Hartford’s supervision and settle the case only with The Hartford’s approval:

If [The Hartford] elects not to investigate, settle or defend any such claim or suit, the [City] under the supervision of [The Hartford] shall arrange for such investigation and defense thereof as are reasonably necessary, and subject to prior authorization of [The Hartford], shall effect such settlement thereof as [The Hartford] and the City deem expedient.

(*Id.*) Unlike in the excess policies, defense costs incurred by either the City or The Hartford count against the umbrella policies’ limits:

All expenses incurred by [The Hartford] or the [City] in the investigation, settlement and defense of claims or suits shall be charged against the limit of [The Hartford’s] liability with respect to ultimate net loss. . . .

(*Id.*) Thus, the City’s defense costs are part of the ultimate net loss and reimbursable by The Hartford up to the umbrella policies’ limit. That limit varied from year to year, but the first-year limit was “\$10,000,000 part of \$20,000,000.” (*Id.* at 28.)

**C. The City's communication with The Hartford regarding the asbestos lawsuit**

On May 2, 2014, the City notified The Hartford of the pending asbestos lawsuit. (Doc. 69-4 at 2–5.) The City maintained that it had “exceeded” the retained limit under The Hartford’s excess policies “by expending more than \$500,000 for its legal defense.” (*Id.* at 3.) Accordingly, the City “demand[ed] that [The Hartford] unconditionally and fully defend and indemnify Phoenix against any liability” in the lawsuit. (*Id.* at 2.)

On May 9, The Hartford sent a response letter. (Doc. 66-21.) The letter asked for the City’s “assistance in helping [The Hartford] determine [its] coverage obligations, if any,” for the asbestos lawsuit. (*Id.* at 2.) The letter specifically requested, among other things, proof that the City exhausted the retained limit under the insurance policies. (*Id.* at 3.)

On October 14, the City sent a follow-up letter claiming coverage under the excess and umbrella policies. (Doc. 69-4 at 7–8.) The City stated that it “expects The Hartford to communicate its coverage position in writing within 10 days of receipt of this letter.” (*Id.* at 8.)

On November 6, the City sent another letter. (*Id.* at 10–12.) The City stated that it “expects The Hartford to immediately acknowledge receipt of our prior correspondence and advise when it will produce a written coverage position.” (*Id.* at 10.) As “proof of exhaustion” of the retained limit, the letter included an email from the City’s attorney stating that the City had spent more than \$1,000,000 so far defending the asbestos lawsuit. (*Id.* at 11.) The City also noted that Ms. Tarazon had renewed her settlement offer of \$10,500,000. (*Id.*)

That day, The Hartford told the City in an email that the retained limit “must be horizontally exhausted,” i.e., that “the duty to defend under the excess policies is not triggered until all of the [retained limits] on the triggered policies has [sic] been exhausted.” (*Id.* at 14.) The email also requested “invoices and canceled checks as proof of exhaustion.” (*Id.*)

1 On November 7, the City informed The Hartford by email that Ms. Tarazon had  
2 offered to settle for \$7,000,000. (Doc. 69-1 at 114.)

3 On November 18, The Hartford repeated its request for “billing records.” (Doc.  
4 69-4 at 16.)

5 On December 18, the City sent The Hartford billing records showing more than  
6 \$1,000,000 in defense costs. (*Id.* at 18–21.)

7 On January 13, 2015, The Hartford stated in an email that it “requires the billing  
8 records in order to determine whether or not the [retained limits] have been properly  
9 exhausted” and that “billing records are a threshold issue that must be addressed prior to  
10 [The] Hartford issuing a coverage position.” (*Id.* at 23.) The City pointed out that this  
11 statement “suggests that you have not reviewed the billing records we provided to you on  
12 December 18.” (*Id.*)

13 On January 23, The Hartford emailed the City to arrange a conference call. (Doc.  
14 66-25 at 3.) In a follow-up email, The Hartford stated that the purpose of the call would  
15 be to discuss whether the City had exhausted the policies’ retained limits, given the long  
16 duration of the asbestos exposure. (*Id.*) The Hartford also stated that it “just recently  
17 received the invoices” for the defense costs. (*Id.*)

18 On March 5, the City notified The Hartford that it offered to settle with Ms.  
19 Tarazon for \$500,000 because a reasonable verdict could reach \$1,500,000. (Doc. 69-4  
20 at 27.) The Hartford responded that it “neither approves nor disapproves of the  
21 settlement” and maintained that it was “not participating in the defense” of the lawsuit  
22 because “the City has not exhausted its retained limits.” (*Id.*)

23 The City brought this action against The Hartford on its excess and umbrella  
24 policies covering all four years it was on the risk. The City claims that The Hartford (1)  
25 breached one or more of its insurance contracts by refusing to pay the City’s settlement  
26 payment and defense costs in the asbestos lawsuit and (2) acted in bad faith by refusing to  
27 make the above payments and by failing to timely investigate and respond to the City’s  
28

1 coverage claims. (The City also seeks declaratory judgment as to The Hartford's  
2 coverage obligations, but declaratory judgment is unwarranted because the coercive  
3 remedy of damages is adequate to adjudicate all claims.)

4 The City moves for summary judgment on its breach of contract and declaratory  
5 judgment claims. (Doc. 68.) The Hartford cross-moves for summary judgment on all  
6 claims. (Doc. 65.) Oral argument was held on August 16, 2016.

### 7 8 **III. INTERPRETATION OF THE INSURANCE POLICIES**

9 The parties agree that Arizona law applies. Interpretation of an insurance policy is  
10 a question of law. *Sparks v. Republic Nat. Life Ins. Co.*, 132 Ariz. 529, 534, 647 P.2d  
11 1127, 1132 (1982). Provisions are to be construed according to their “plain and ordinary  
12 meaning” and in a way that gives “reasonable and harmonious meaning and effect” to all  
13 provisions. *Id.* at 534–36, 647 P.2d at 1132–34 (citation omitted). If a provision appears  
14 ambiguous, courts look to other interpretive guides such as legislative goals, social  
15 policy, and the transaction as a whole. *First Am. Title Ins. Co. v. Action Acquisitions,*  
16 *LLC*, 218 Ariz. 394, 397, 187 P.3d 1107, 1110 (2008). If ambiguity remains after  
17 considering these factors, the provision is to be construed against the insurer. *Id.* The  
18 City was a sophisticated insured and self-insurer.

19 The parties agree that the asbestos exposure was an “occurrence” that triggered  
20 The Hartford's policies. The question is whether the City's \$500,000 settlement payment  
21 and \$1,400,000 in defense costs are covered and therefore reimbursable under any of the  
22 policies.

23 Because the parties have not presented evidence of negotiations or other  
24 communications between the City and The Hartford when the City purchased the  
25 policies, resolution of the disputes turns on the policy terms, the nature of the coverages,  
26 the relation among the coverages, and the reasonable expectations of sophisticated  
27 participants in the insurance industry.

1           **A.     Excess policies**

2           At the outset, the City argues that The Hartford's policies were actually "primary"  
3 policies because the City's self-insured retention was not an underlying insurance policy.  
4 In support of this position, the City quotes a line from the Arizona Supreme Court in  
5 *State Farm Mutual Automobile Insurance Co. v. Bogart*: "a self-insurer is not an insurer."  
6 149 Ariz. 145, 150, 717 P.2d 449, 454 (1986).

7           That line has nothing to do with this case. The point in *Bogart* was that a self-  
8 insured rental car company is not, by virtue of being self-insured, an insurer of one of its  
9 renters for purposes of "other insurance" clauses in the renter's insurance policies. That  
10 unremarkable proposition does not mean the City can ignore its own self-insured  
11 retention and access first-dollar coverage from The Hartford. "It is well recognized that  
12 self-insurance retentions are the equivalent to primary liability insurance, and that  
13 policies which are subject to self-insured retentions are 'excess policies' which have no  
14 duty to indemnify until the self-insured retention is exhausted." *Pac. Emp'rs. Ins. Co. v.*  
15 *Domino's Pizza, Inc.*, 144 F.3d 1270, 1276–77 (9th Cir. 1998) (applying California law).  
16 Lest there be any doubt, the excess policies' declarations page confirms that the policies  
17 cover only "excess liability." (Doc. 69-2 at 2.)

18           Having clarified the nature of the excess policies, the Court turns to resolving the  
19 parties' competing interpretations of specific policy provisions.

20           **1.     The Hartford has no duty to indemnify the City for any of the  
21 settlement.**

22           a.     Under the basic insuring clause, quoted above at Part II.B.1.a, The Hartford  
23 must indemnify the City for "ultimate net loss" incurred in excess of a \$500,000  
24 "retained limit." (Doc. 69-2 at 3.) As also quoted above at Part II.B.1.a, "ultimate net  
25 loss" means settlements or judgments for which the City is liable, including court-  
26 awarded fees and costs, "but excludes all loss adjustment expenses" of the City and The  
27 Hartford. (*Id.* at 10.) The City settled the asbestos claim for \$500,000, within its retained  
28 limit, so The Hartford has no obligation to indemnify the City for any of the settlement.

1           b.       The City argues that its pre-settlement defense costs of more than \$500,000  
2 “eroded” the retained limit, such that *all* of the settlement was in excess of the retained  
3 limit. It seeks complete indemnification for the \$500,000 settlement amount. This  
4 contention defies the definitions of the excess policy. The declarations page limits  
5 coverage to “excess liability.” (*Id.* at 2.) Under the basic insuring clause, The Hartford’s  
6 duty to indemnify is limited to excess “ultimate net loss.” (*Id.* at 3.) “Ultimate net loss”  
7 is the sum for which the City is liable to a third party “but excludes all loss adjustment  
8 expenses” of the City. (*Id.* at 10.) *See Planet Ins. Co. v. Mead Reinsurance Corp.*, 789  
9 F.2d 668, 671–72 (9th Cir. 1986) (interpreting identical definition of “ultimate net loss”  
10 as not including defense costs). These clauses clearly exclude defense costs from  
11 counting toward satisfaction of the retained limit.

12           Even when an excess policy is silent on whether underlying defense costs satisfy  
13 the underlying policy limit, it is unreasonable for a sophisticated insured to assume they  
14 do. *See* 1-1 *New Appleman Law of Liability Insurance* § 1.05[2][f] (2015) (“Defense  
15 costs under most CGL [commercial general liability] policies are outside of the policy  
16 limits, meaning that payment of defense costs by an insurer does not reduce the amount  
17 available to pay judgments or settlements.”); 3-29A *New Appleman Insurance Law*  
18 *Practice Guide* § 29A.20 (2015) (“An excess carrier that is not specifically told by the  
19 insured or its broker that the underlying primary coverage is self-liquidating rightly  
20 assumes that defense costs will be paid in addition to the primary policy limits and prices  
21 its policy accordingly.”).

22           But there is more. The excess policies do not merely exclude defense costs from  
23 satisfying the retained limit. They speak explicitly to how defenses costs are to be  
24 treated. As discussed below, the policies disclaim responsibility for all such costs when,  
25 as here, the claim is adjusted within the retained limit. They also require proportional  
26 sharing of defense costs if the claim is adjusted for more than the retained limit. The  
27  
28

1 City's position that defense costs erode its retained limit contradicts these policy terms as  
2 well.

3 c. The City relies on a clause in the excess policies, quoted above at Part  
4 II.B.1.b, stating that the City's participation in defense costs shall not "exceed the  
5 retained limit." (Doc. 69-2 at 3.) But that clause must be read in context. It appears in  
6 the policy section titled "Defense, Settlement and Supplementary Payments," not the  
7 basic insuring clause. As explained below, the clause applies only when ultimate net loss  
8 is adjusted above \$500,000 and the City and The Hartford split defense costs. In that  
9 situation, the clause limits the City's share of defense costs to \$500,000.

10 Although the clause refers to the City's "retained limit," it concerns only the dollar  
11 amount of that limit (\$500,000). It does not say that defense costs exhaust that limit for  
12 purposes of The Hartford's duty to indemnify. Rather, the clause relates to The  
13 Hartford's separate duty in some circumstances to pay some of the defense costs, as  
14 explained below.

15 **2. The Hartford has no duty to pay any of the City's defense costs**  
16 **because the City settled within its retained limit.**

17 a. The policy section titled "Defense, Settlement and Supplementary  
18 Payments" addresses The Hartford's duty to pay the City's defense costs. The first  
19 sentence, which will be referred to as the "No Costs" provision, states that The Hartford  
20 shall not pay any defense costs for a claim that is "adjusted" for an amount within the  
21 retained limit:

22 Should any claim arising from such occurrence be adjusted  
23 prior to trial court judgment for a total amount not more than  
24 the retained limit, then no loss expenses or legal expenses  
shall be payable by [The Hartford].

25 (Doc. 69-2 at 3.)

26 That provision governs here. The asbestos claim against the City was adjusted  
27 within the retained limit of \$500,000. The No Costs provision places the City in exactly  
28 the same position as a primary insurer, which the City used to have before it decided to



1 save that premium and self-insure for the first \$500,000 of loss. Typically and unless  
2 drafted otherwise, the primary insurer is liable for the policy limit in loss indemnification  
3 and for unlimited defense costs.

4 b. The City argues that the No Costs provision does not apply here because  
5 the City “adjusted” the claim for a higher amount than it settled it for. The City interprets  
6 the word “adjusted” to include not only the ultimate settlement amount, but also the  
7 amount spent defending the claim on the way to settlement.

8 The City’s interpretation contradicts plain meaning. The word “adjusted” in the  
9 No Costs provision refers to the settlement amount which the City agreed to pay. Black’s  
10 Law Dictionary at that time defined “adjustment” as:

11 An arrangement; a settlement. *In the law of insurance, the*  
12 *adjustment of a loss is the ascertainment of its amount and*  
13 *the ratable distribution of it among those liable to pay it.* The  
14 settling and ascertaining the amount of the indemnity which  
15 the assured, after all allowances and deductions made, is  
entitled to receive under the policy, and fixing the proportion  
which each underwriter is liable to pay.

16 *Adjustment*, Black’s Law Dictionary (5th ed. 1979) (emphasis added).

17 The City’s interpretation also conflicts with surrounding policy language. As  
18 explained, The Hartford’s duty to indemnify applies only when the retained limit is  
19 exhausted by liability indemnification, not by defense costs. If the word “adjusted” in the  
20 No Costs provision includes both liability and defense costs, then the retained limit would  
21 be met for purposes of reimbursing defense costs *before* it is met for indemnity purposes.  
22 That makes no sense for an excess policy, which is always grounded on a primary policy  
23 (or its equivalent, a self-insured retention), which itself has an underlying duty to defend.

24 Furthermore, the sentence immediately following the No Costs provision uses the  
25 word “adjust” to mean settling or adjudicating the amount of liability excluding defense  
26 costs, as discussed below.

1 c. Applying the No Costs provision to claims settled within the retained limit  
 2 harmonizes with the following sentence. That provision, which will be referred to as the  
 3 “Proportional Costs” provision, describes when The Hartford must pay a proportion of  
 4 the City’s defense costs and how much:

5 However, should the total amount for which such claim might  
 6 be adjusted prior to such judgment exceed the retained limit,  
 7 then if [The Hartford] consents to further trial court  
 8 proceedings, it *shall contribute to legal expenses in the ratio*  
 9 *which its proportion of the liability for the judgment*  
 10 *rendered, or settlement made, bears to the whole amount of*  
 11 *said judgment or settlement*, however in no event shall the  
 12 [City’s] participation in such legal expenses exceed the  
 13 retained limit . . . .

14 (Doc. 69-2 at 3 (emphasis added).) Under this provision, The Hartford’s duty to  
 15 reimburse the City’s defense costs is explicitly contingent on, and proportional to, its  
 16 duty to indemnify some of the City’s “liability.” For example, if the City settles a claim  
 17 for \$600,000 and the defense costs are \$300,000, The Hartford would be responsible for  
 18 one-sixth of the settlement liability (\$100,000) and therefore one-sixth of the defense  
 19 costs (\$50,000). Conversely, if the City settles a claim for \$500,000 or less, The Hartford  
 20 would be responsible for none of the settlement liability and none of the defense costs. In  
 21 that circumstance, the Proportional Costs provision says the same thing as the No Costs  
 22 provision in the preceding sentence. As another court has noted, the No Costs and  
 23 Proportional Costs provisions taken together “plainly support” the conclusion that the  
 24 policyholder is “responsible for defense costs for claims it settled within its SIR [self-  
 25 insured retention] amount.” *City of Oxnard v. Twin City Fire Ins. Co.*, 37 Cal. App. 4th  
 26 1072, 1079, 44 Cal. Rptr. 2d 177, 180 (1995).

27 d. The last clause of the Proportional Costs provision benefits the City by  
 28 placing a maximum on the City’s “participation in such legal expenses.” (Doc. 69-2 at  
 3.) That clause will be referred to as the “Costs Ceiling.” “[S]uch legal expenses” means  
 the legal expenses referred to in that sentence: the expenses of defending a claim that

1 settles or is adjudicated for more than \$500,000. Although the City generally participates  
2 in such defense costs in proportion to its liability, the Costs Ceiling ensures that the City  
3 does not pay more than the “retained limit,” or \$500,000, in such costs.

4 Whereas the basic insuring clause uses the \$500,000 “retained limit” as the  
5 amount the City must pay in ultimate net loss before the insurer must pay anything for  
6 liability, the Costs Ceiling refers to the “retained limit” as shorthand for a separate  
7 \$500,000 boundary. Unlike the basic insuring clause, the No Costs provision,  
8 Proportional Costs provision, and Costs Ceiling govern The Hartford’s duty to pay  
9 defense costs. Therefore, the Costs Ceiling’s reference to the “retained limit” simply  
10 incorporates the amount that the limit represents, \$500,000, as an independent limitation  
11 on the City’s responsibility for defense costs.

12 The City argues that the language of the Costs Ceiling—“in no event” shall the  
13 City’s “participation in such legal expenses exceed the retained limit”—not only limits  
14 the City’s proportional sharing obligation established in the same sentence, but also  
15 applies in circumstances where the City would otherwise be responsible for all the  
16 defense costs. But insurance policies, like all contracts, should be interpreted to give  
17 effect to every provision. The interpretation of one provision “must not render a related  
18 provision meaningless.” *Aztar Corp. v. U.S. Fire Ins. Co.*, 223 Ariz. 463, 476, 224 P.3d  
19 960, 973 (Ct. App. 2010). The City’s argument would extinguish entirely the No Costs  
20 provision in the immediately preceding sentence.

21 The Costs Ceiling is part of and qualifies the Proportional Costs provision, not the  
22 No Costs provision. The Proportional Costs provision’s reference to claims that “might  
23 be adjusted” for more than \$500,000 recognizes that not all claims will be adjusted that  
24 high. The phrase “in no event” does not extend beyond the mutual costs sharing  
25 obligation created in the same sentence. Thus, the Costs Ceiling does not apply here, and  
26 The Hartford still has no duty to pay any defense costs.

1                   **3.     Alternatively, reimbursement of defense costs is allocated across**  
 2                   **policy periods and no year exceeds the City’s retained limit,**  
 3                   **however calculated.**

4           a.     Suppose all the foregoing rulings are wrong and the excess policies do  
 5     impose on The Hartford some duty to pay defense costs once the City incurs at least  
 6     \$500,000 in defense costs, indemnity costs, or both. The question would remain whether  
 7     the City actually did incur \$500,000 in costs, however calculated, in any single policy  
 8     period. Here, though the City spent more than \$1,400,000 in defense costs, those costs  
 9     were spent defending a claim arising from an occurrence—asbestos exposure—that  
 10    spanned four of The Hartford’s policy periods and twenty-six years altogether.

11           The parties address this complication in different ways. The Hartford says the  
 12    City’s defense costs, like the indemnity obligation, should be allocated across all policies  
 13    covering the City during the twenty-six-year period of asbestos exposure. On this view,  
 14    the City never incurred more than the retained limit of \$500,000 in any costs in any of  
 15    The Hartford’s policy years. The City, on the other hand, seeks to apply all its defense  
 16    costs to one policy of its choice. On that view, the City incurred more than \$500,000 in  
 17    defense costs for the selected policy year.

18           This dispute, though it involves the allocation of defense costs, resembles a more  
 19    familiar debate in insurance law over how to allocate an insured’s liability when it arises  
 20    from a single occurrence spanning multiple policy periods. *See 1-1 New Appleman Law*  
 21    *of Liability Insurance* § 1.10[2] (2015). The Hartford’s approach, known as the “pro  
 22    rata” method, allocates liability among all policies in place during the occurrence. *Id.*  
 23    The City’s approach, known as the “all sums” or “pick and choose” method, allows the  
 24    insured to select any of the policies to cover the liability, and the insurer on the selected  
 25    policy may then seek contribution from other insurers. *Id.* Arizona cases are silent,<sup>2</sup> but  
 26    most states favor pro rata allocation. (*See* Doc. 66-32 at ¶ 109.)

---

27           <sup>2</sup> The Court declines the City’s request to certify this question to the Arizona  
 28    Supreme Court. (Doc. 74 at 12.) The question is not dispositive, as other grounds  
 independently govern this case. The question is not very difficult. There is no urgency to

1           b.       The City has a threshold problem under its “pick and choose” approach that  
2 it did not pick and choose one policy year. It picked and chose four policy years. It  
3 made demand and filed suit against The Hartford on its excess and umbrella policies for  
4 all four of its years. The City cites no authority that would deny a carrier sued for  
5 multiple policy periods, or multiple carriers sued together for multiple policy periods,  
6 allocation at least among the policies and the policy periods for which suit is actually  
7 brought. Nor would it make any sense to do so. Allocating only among the policy  
8 periods for which the City sued The Hartford, and further assuming the City is entitled to  
9 repayment of all its ultimate net loss and defense costs, the City’s total costs per year  
10 would be less than the \$500,000 retained limit in each year. The City still would have no  
11 claim against The Hartford for any costs.

12           c.       Even apart from the fact that the City has sued under multiple policy years,  
13 pro rata allocation of the City’s liability and defense costs makes sense in light of the  
14 excess policies’ language. The basic insuring clause in each policy is limited to liability  
15 “caused by an occurrence, during the policy period.” (Doc. 69-2 at 3.) Similarly, the  
16 duty to pay defense costs is limited to claims arising from an “occurrence,” which is  
17 defined as an event that results in bodily injury “during the policy term.” (*Id.* at 3, 9.)  
18 The most reasonable reading of these provisions is that each policy applies only to  
19 liability—and associated defense costs—caused by asbestos exposure that occurred  
20 within the policy period. *See Boston Gas Co. v. Century Indem. Co.*, 454 Mass. 337,  
21 358–360 & n.34, 910 N.E.2d 290, 306–08 & n.34 (2009) (interpreting similar policy  
22

---

23 answer the question. Even if all the defense and indemnity costs are allocated only  
24 among The Hartford’s policies on which this action is brought, the City’s total indemnity  
25 and defense expenses fall short of the \$2,000,000 needed to exceed the \$500,000 retained  
26 limit for any of those four years. No question is worthy of certification if it is not worthy  
27 of appeal, and it is not clear that the City would appeal and run up its own attorneys’ fees  
28 and risk assessment of The Hartford’s attorneys’ fees on appeal. *See* A.R.S. § 12-  
341.01(A). If the City does appeal, the Court of Appeals can then decide whether  
certification is necessary.

1 language to support pro rata allocation of liability and collecting cases supporting that  
2 interpretation). Notably, the policies do not contain sweeping language obliging The  
3 Hartford to pay “all sums” for which the City is liable, as is sometimes argued as a reason  
4 for allocating all liability and costs to one policy instead of pro rata. *See, e.g., State v.*  
5 *Cont’l Ins. Co.*, 55 Cal. 4th 186, 193, 199, 281 P.3d 1000, 1003, 1007 (2012).

6 Pro rata allocation of liability and defense costs is also consistent with the City’s  
7 reasonable expectations. The City cannot have reasonably expected any single one-year  
8 occurrence-based policy to cover all its liability and defense costs associated with twenty-  
9 six years of asbestos exposure. *See Boston Gas*, 454 Mass. at 363, 910 N.E.2d at 309  
10 (“No reasonably policyholder could have expected that a single one-year policy would  
11 cover all losses caused by toxic industrial wastes released into the environment over the  
12 course of several decades.”). This is especially true because The Hartford’s policies were  
13 excess policies to apply only after the City exhausted a self-insured retention. Because  
14 the excess policies insured less risk than primary policies, they charged relatively low  
15 premiums. Thus, to allow the City to assign all its defense costs in the asbestos lawsuit to  
16 one policy year, thereby triggering an excess insurer’s duty to pay defense costs, would  
17 essentially allow the City to “manipulate the source of its recovery and avoid the  
18 consequences of its decision to become self-insured.” *Missouri Pac. R. Co. v. Int’l Ins.*  
19 *Co.*, 288 Ill. App. 3d 69, 82, 679 N.E.2d 801, 810 (1997).

20 In addition, pro rata allocation serves public policies of fairness and efficiency for  
21 courts and litigants alike. It “avoids saddling one insurer with the full loss, the burden of  
22 bringing a subsequent contribution action, and the risk that recovery in such an action  
23 will prove to be impossible because, for instance, the insurer of the other triggered  
24 policies is unable to pay.” *Boston Gas*, 454 Mass. at 365, 910 N.E.2d at 311 (quoting  
25 *Olin Corp. v. Insurance Co. of N. Am.*, 221 F.3d 307, 323 (2d Cir. 2000)). It also allows  
26 courts to divide liability among multiple insurers all at once, rather than slogging through  
27 “two separate suits” and risking inconsistent rulings in the absence of overall “guidance  
28

1 as to how to allocate liability.” *Id.* at 364–65, 910 N.E.2d at 311 (quoting *Energy North*  
2 *Natural Gas, Inc. v. Certain Underwriters at Lloyd’s*, 156 N.H. 333, 345, 934 A.2d 517,  
3 527 (2007)). Indeed, if one carrier had to pay the entire loss, it would face the same  
4 impossibility of proving actual shares of damages in seeking contribution from the other  
5 carriers on the same occurrence—unless that contribution action itself adopted a pro rata  
6 approach.

7 d. Despite these reasons to adopt pro rata allocation, the City argues that the  
8 lack of consensus on the issue is a policy ambiguity that must be resolved in its favor,  
9 relying on *City of Glendale v. National Union Fire Insurance Co. of Pittsburgh*, No. CV-  
10 12-380-PHX-BSB, 2013 WL 1296418, at \*9 (D. Ariz. Mar. 29, 2013). That case turned  
11 on a specific policy term: namely, whether the phrase “invasion of the right of private  
12 occupancy” means physical invasion of real property or something broader. *Id.* at \*5.  
13 Some jurisdictions had defined the term narrowly, whereas others had defined it broadly.  
14 *Id.* at \*9. After reviewing case law, dictionary definitions, and other policy terms, the  
15 court deemed the term ambiguous and interpreted it in favor of the insured. *Id.* at \*5–11.  
16 That is not this case.

17 There is no ambiguous policy language concerning allocation over policy periods.  
18 There is a difficulty—indeed, impossibility—of proving precisely how much damage  
19 arose from asbestos exposure before the policy periods, how much from additional  
20 exposure in the policy periods, and how much from yet further exposure in later periods.

21 Disputes in policy meaning are not central in cases allocating damages for  
22 occurrences over time. The policy language here is crystal clear. The Hartford is liable  
23 only for damages for occurrences within its policy periods. It is a matter of fact, not  
24 policy ambiguity, how much damage was caused by exposure in one policy period when  
25 a single occurrence spans multiple policy periods. The judicial disagreement on  
26 allocation is not primarily about policy meaning but about the best balance of efficiency,  
27 accuracy, and fairness in finding facts that cannot be proven specifically. Here, pro rata  
28



1 allocation of the City's liability and defense costs is the most consistent with policy  
2 language and the most reasonable way to resolve that inherently factual matter. Arizona  
3 is most likely to follow the pro-rata allocation that most jurisdictions do.

4 e. The City argues that allocating an insured's liability is conceptually  
5 different from allocating defense costs under a straight duty to defend. For example, the  
6 First Circuit recently declined to extend Massachusetts' pro rata method of allocating  
7 liability to an allocation of defense costs where the parties had not thoroughly briefed the  
8 issue. *Peabody Essex Museum v. U.S. Fire Ins. Co.*, 802 F.3d 39, 52–53 (1st Cir. 2015).  
9 In that case, the insurer had an explicit "duty to defend" the insured, *id.* at 46 n.9, and the  
10 First Circuit worried that allocating defense costs among policy periods might contravene  
11 Massachusetts' "complete defense" rule, under which an insurer with a duty to defend  
12 any claim in a lawsuit must defend the entire lawsuit, *id.* at 53 (quoting *GMAC Mortg.*,  
13 *LLC v. First Am. Title Ins. Co.*, 464 Mass. 733, 738, 985 N.E.2d 823, 827 (2013)).

14 Fortunately, those concerns do not apply here. Under all The Hartford's policies,  
15 defense costs should be allocated the same way as liability. Unlike the insurer in  
16 *Peabody Essex*, The Hartford has no duty to provide a defense under any of its policies.  
17 Its only duty as to defense is to contribute to the City's costs in defending itself under the  
18 explicit formulas and limits in the policies. (Doc. 69-2 at 3; Doc. 69-3 at 41.)<sup>3</sup> Thus,  
19 there is no risk of violating Arizona's complete defense rule, which governs duties to  
20 provide a defense, not duties to contribute to the costs of a defense by the insured. *See*  
21 *Regal Homes, Inc. v. CAN Ins.*, 217 Ariz. 159, 169, 171 P.3d 610, 620 (Ct. App. 2007)  
22 (stating complete defense rule); *Gulf Chem. & Metallurgical Corp. v. Associated Metals*  
23 *& Minerals Corp.*, 1 F.3d 365, 372 (5th Cir. 1993) (allocating defense costs pro rata and  
24 noting that "[t]hough we approve the concept of apportioning the *cost* of an insured's

---

25 <sup>3</sup> The City contends the excess policies impose a duty to defend, according to a  
26 Ninth Circuit case involving identical policy language. *Planet Ins. Co. v. Mead*  
27 *Reinsurance Corp.*, 789 F.2d 668 (9th Cir. 1986). But that case did not identify any duty  
28 to defend apart from a duty to pay defense costs.



1 defense among those liable for exposure risk during the period for which claims are made  
2 against the insured, we do not limit the *duty* of defending the insured”); *accord Sec. Ins.*  
3 *Co. of Hartford v. Lumbermens Mut. Cas. Co.*, 264 Conn. 688, 711–13, 826 A.2d 107,  
4 122–23 (2003) (allocating defense costs pro rata despite objection that duty to defend is  
5 broader than duty to indemnify).

6 f. Courts subscribing to pro rata allocation have several methods to apportion  
7 liability among policies. *See* 1-1 *New Appleman Law of Liability Insurance* § 1.10[2]  
8 (2015). Common methods include apportioning liability based on (1) the time the policy  
9 was exposed to injury, known as “time on the risk,” (2) the degree of injury that occurred  
10 during the policy period, and (3) the time the policy was exposed to the injury, multiplied  
11 by the policy’s liability limit, known as “time on risk times limits.” *Id.* (citations  
12 omitted).

13 The time-on-the-risk method is the most practical, both in general and here  
14 because the underlying settlement resolved no other facts that would permit application  
15 of a different method. *See Boston Gas*, 454 Mass. at 370, 910 N.E.2d at 314 (“[T]he  
16 time-on-the-risk method of allocating losses is appropriate where the evidence will not  
17 permit a more accurate allocation of losses during each policy period.”). The other  
18 methods risk great complexity and increase in litigation expense, to the cost of insureds  
19 and insurers alike, with questionable increase in accuracy. The Arizona Supreme Court  
20 is unlikely to adopt a method that would force the insured to try the case he settled in  
21 order to get his insurance, when there is a much simpler way to allocate loss fairly among  
22 all carriers.

### 23 **B. Umbrella policies**

24 The umbrella policies generally apply only after the excess policies are exhausted.  
25 They indemnify excess liability and applicable defense expenses incurred by the City.

1                   **1. The Hartford has no duty to indemnify the City for any of the**  
2                   **settlement or defense costs in this case.**

3           a. Under the basic insuring clause, The Hartford must indemnify the City for  
4 “ultimate net loss” due to bodily injury in excess of “the underlying limit” or “the self-  
5 insured retention,” whichever is higher:

6                   The [Hartford] will indemnify the [City] for ultimate net loss  
7                   in excess of the underlying limit or the self-insured retention,  
8                   whichever is the greater, because of . . . bodily injury . . . .

9 (Doc. 69-3 at 41.) The “underlying limit” refers to the coverage limit in the excess  
10 policies: \$500,000 beyond the City’s \$500,000 retained limit, or \$1,000,000 altogether.  
11 (See *id.* at 28, 44.) The “self-insured retention” refers to a deductible of \$25,000 for  
12 primary coverages for liability not covered by the excess policies, such as aircraft-related  
13 liability. (See *id.* at 28, 44; Doc. 69-2 at 5.) Thus, the umbrella policies insure against  
14 two types of liability: (1) liability that falls within the scope of the excess policies but  
15 exceeds \$1,000,000 and (2) liability for other coverage that falls outside the scope of the  
16 excess policies and exceeds \$25,000. The City’s asbestos liability fell within the scope of  
17 the excess policies (*see* Doc. 68 at 8), so this case involves The Hartford’s duty to  
18 indemnify loss above the excess policies’ limit of \$1,000,000.

19           The City did not incur liability above the excess policies’ limit, or any liability at  
20 all under the excess policies. Although the City incurred more than \$1,400,000 in  
21 defense costs, that did not count toward the excess policies’ coverage limit as previously  
22 discussed. Because the City did not exhaust excess policy coverage, it cannot access any  
23 umbrella coverage.

24           b. The City notes that the umbrella policies include defense costs in “ultimate  
25 net loss,” as quoted above at Part II.B.2.a, which means indemnity under the policies is  
26 for applicable defense costs. (Doc. 69-3 at 44.) The City also notes that defense costs in  
27 the umbrella policies are charged against policies’ coverage limit. (*Id.* at 41.) From that  
28 the City contends the umbrella policies go back to pay for all prior defense costs not

1 previously insured. Under the City's argument the umbrella insurer would pay all  
 2 defense costs in the asbestos lawsuit above \$500,000, even though those defense costs  
 3 were incurred in connection with liability not covered by either the excess or umbrella  
 4 policies. That is not how umbrella insurance works. "Where an excess policy does  
 5 provide for a duty to defend, that duty will generally not arise until the policy limits of  
 6 the primary insurer's coverage are exhausted." 1-1 *New Appleman Law of Liability*  
 7 *Insurance* § 1.05[2] (2015). The City's contention is unreasonable, and no insured could  
 8 have reasonably expected such rights in umbrella insurance even if the policy text did not  
 9 necessarily preclude it.

10 In any event, the terms and structure of the umbrella policies preclude the City's  
 11 interpretation. The Hartford's duty to pay the City's defense costs is governed by the  
 12 excess policies until the City's liability reaches \$1,000,000. Only then do the umbrella  
 13 policies begin to apply. This structure explains why the umbrella policies list the excess  
 14 policies as "underlying" and charge a much smaller premium. (*Compare* Doc. 69-3 at 28  
 15 *with* Doc. 69-2 at 2.) Any duty to defend under the umbrella policies is limited to claims  
 16 "to which this policy applies" (Doc. 69-3 at 41), and the policy applies only to claims for  
 17 which the underlying retained limit and excess policy have been exhausted.

## 18 **2. The Hartford had no duty to provide a defense.**

19 a. The policy section titled "Investigation, Defense, Settlement" sets forth The  
 20 Hartford's duty to defend. As quoted above at Part II.B.2.b, any such duty is limited to  
 21 claims "to which this policy applies" and "which no underlying insurer is obligated to  
 22 defend." (Doc. 69-3 at 41.) The Hartford has the option to provide the defense, or as  
 23 happened here, it may "elect[] not to investigate, settle or defend any such claim or suit"  
 24 and leave the City to provide its defense, as in the excess policies. (*Id.*)

25 b. The City argues that it expected a defense from the beginning of the  
 26 asbestos lawsuit because the duty to defend under the umbrella policies extends to claims  
 27 that "no underlying insurer is obligated to defend." (*Id.*) All that means is that if an  
 28 underlying insurer is obligated by its own policy to defend or pay defense costs after its

1 own duty to indemnify is exhausted, The Hartford's umbrella policies do not take on that  
2 duty in place of the underlying carrier for the umbrella tranche of coverage. It protects  
3 the umbrella insurer in cases where another policy provides a duplicative duty to defend.

4 It is common in insurance for liability insurers whose duty to indemnify has been  
5 exhausted to continue to have a duty to defend. That is the norm for primary insurance  
6 with no excess policy. The same could apply in this array of self-insurance in place of  
7 primary insurance, followed by excess insurance, followed by umbrella insurance. To  
8 illustrate, suppose the City's liability were high enough to trigger coverage under the  
9 excess policies but not the umbrella policies and the City's defense costs exceeded  
10 \$1,000,000. In that case, the excess carrier (which happens to be The Hartford) would  
11 have to reimburse all the City's defense costs above \$500,000. This clause in the  
12 umbrella policies preserves that duty of an excess carrier to pay those defense costs.

13 In any event, for purposes of this provision, the City itself is plainly and in  
14 substance an underlying insurer expressly obligated to defend and bear the costs of  
15 defense, subject to some rights to reimbursement under the excess policies that never  
16 came into play. That reality is apparent from the excess policy terms. As has been  
17 noted, the City supplanted its earlier primary carrier with itself and took on the  
18 obligations of the primary carrier. The City must have been an underlying insurer in the  
19 sense of the umbrella policies because the excess policies specifically contemplated that  
20 the City would defend certain claims at its own cost, as any primary insurer would.

21 The City protests that it is not an "underlying insurer" for purposes of the umbrella  
22 policies because, as the Arizona Supreme Court observed in *Bogart*, "a self-insurer is not  
23 an insurer." 149 Ariz. at 150, 717 P.2d at 454. As has already been discussed, *Bogart* is  
24 beside the point. It did not address whether a self-insurer is an underlying insurer for  
25 purposes of *its own* excess or umbrella policies. Thus, the City was an "underlying  
26 insurer" with a duty to defend for purposes of the umbrella policies.

1           The City cites two cases in which an excess insurer had a duty to defend even  
2 though primary coverage had not been exhausted. *Johnson Controls, Inc. v. London*  
3 *Market*, 325 Wis. 2d 176, 784 N.W.2d 579 (2010); *IMG Worldwide, Inc. v. Westchester*  
4 *Fire Ins. Co.*, 572 Fed. Appx. 402 (6th Cir. 2014). But neither of those cases addressed  
5 whether a policyholder with a self-insured retention is an “underlying insurer” for  
6 purposes of a higher insurer’s duty to reimburse defense costs. Here, under the  
7 contractual arrangement between the City and The Hartford as established by the excess  
8 and umbrella policies, The Hartford had no duty to defend the asbestos claim.

9  
10 **IV. BAD FAITH**

11           The City conceded at oral argument that if The Hartford has no payment  
12 obligation under the excess or umbrella policies, then the City has no bad faith claim.  
13 There is no payment obligation under the excess or the umbrella policies. Although the  
14 analysis could end there, summary judgment on the bad faith claim is also warranted  
15 regardless of whether The Hartford has a payment obligation, as explained below.

16           An insurer has an obligation to play fairly with its insured. *Zilisch v. State Farm*  
17 *Mut. Auto. Ins. Co.*, 196 Ariz. 234, 237, 995 P.2d 276, 279 (2000). This obligation is  
18 breached when the insurer (1) acts unreasonably toward the insured and (2) knows, or  
19 recklessly disregards, the unreasonableness of its action. *Clearwater v. State Farm Mut.*  
20 *Auto. Ins. Co.*, 164 Ariz. 256, 260, 792 P.2d 719, 723 (1990).

21           The good faith obligation applies to the processing of a claim as well as the  
22 ultimate coverage decision. *Zilisch*, 196 Ariz. at 237–38, 995 P.2d at 279–80. An insurer  
23 may not delay an investigation, force an insured to jump through needless hoops, or  
24 lowball claims in the hopes that the insured will settle for less. *Id.* at 238. Nor may an  
25 insurer deny a claim whose merits are not fairly subject to debate. *Id.* at 237.

26           Knowledge or reckless disregard of unreasonableness does not require intent to  
27 harm, but it requires something more than mistake or inadvertence. *Rawlings v.*  
28 *Apodaca*, 151 Ariz. 149, 160, 762 P.2d 565, 576 (1986). Insurance companies “are far

1 from perfect. Papers get lost, telephone messages misplaced and claims ignored because  
2 paperwork was misfiled or improperly processed. Such isolated mischances may result  
3 in a claim being unpaid or delayed. None of these mistakes will ordinarily constitute a  
4 breach of the implied covenant of good faith.” *Id.* at 157. An insurer must have a  
5 founded belief in its coverage position. *Id.* at 160.

6 The question here is whether there is sufficient evidence from which reasonable  
7 jurors could conclude that The Hartford, in processing and ultimately denying the City’s  
8 claim, “acted unreasonably and either knew or was conscious of the fact that its conduct  
9 was unreasonable.” *Zilisch*, 196 Ariz. at 238, 995 P.2d at 280.

10 **A. Processing of claim**

11 The City alleges that The Hartford processed its claim in bad faith by, among  
12 other things, (1) failing to respond promptly and clearly to the City’s tender of defense  
13 and requests for information, (2) failing to assert its defenses in a timely manner, (3)  
14 changing its coverage positions, and (4) failing to conduct a reasonable investigation.  
15 (*See* Doc. 74 at 15–16.) But the evidence tells a different story.

16 As to timeliness and clarity of The Hartford’s responsive communications, The  
17 City tendered its defense on May 2, 2014. The Hartford responded one week later and  
18 asked for proof that the retained limit had been exhausted. The City provided its  
19 evidence of exhaustion on November 6, nearly six months later. The evidence consisted  
20 of an email from the City’s attorney stating the amount of the City’s defense costs, which  
21 was plainly insufficient. The Hartford immediately clarified that it needed more than  
22 that, and it specifically requested invoices and canceled checks. The City provided the  
23 records on December 18, more than one month later and at the beginning of the holiday  
24 season. The Hartford emailed the City on January 13, 2015 to follow up about the  
25 records and emailed the City on January 23 to arrange a conference call to discuss  
26 exhaustion.

1 As to timeliness of The Hartford's asserted defenses, The Hartford told the City on  
2 November 6, 2014 that the retained limits in each applicable policy period must be  
3 exhausted. Its position has naturally developed from there.

4 As to consistency of The Hartford's coverage position: The Hartford consistently  
5 maintained that the retained limits in each policy period must be exhausted and never said  
6 it would indemnify or defend the City in the asbestos lawsuit. Although the precise legal  
7 basis for The Hartford's position expanded as the dispute evolved, that is an ordinary  
8 feature of litigation. The City's legal positions have shifted as well in the course of this  
9 dispute and litigation.

10 There is no evidence that The Hartford wasted time or ignored general or  
11 statewide insurance law principles. The timing of The Hartford's actions has been  
12 indisputably reasonable and prompt. There is no evidence from which bad faith could be  
13 found in processing the claim, much less that The Hartford knew or was conscious of any  
14 unreasonableness.

15 **B. Denial of claim**

16 The City also alleges that The Hartford denied its claim in bad faith because its  
17 coverage position (1) is unreasonable, (2) fails to give the policy its most natural reading,  
18 (3) fails to resolve policy ambiguities in the City's favor, (4) selectively relies on certain  
19 policy provisions, (5) ignores the fact that the policy is silent on certain issues, and (6)  
20 fails to resolve legal uncertainty in the City's favor.

21 In fact, The Hartford's coverage positions are reasonable even if, contrary to the  
22 rulings in this order, they are not correct. Further, The Hartford's position on allocation  
23 over policy periods is eminently reasonable, even if the Arizona courts rule otherwise in  
24 the future. It could hardly be unreasonable when the majority of jurisdictions adopt it.  
25 Good faith does not require insurers to resolve open legal questions in favor of coverage.  
26 Rather, insurers are entitled to challenge coverage claims that are "fairly debatable."  
27 *Noble v. Nat'l Am. Life Ins. Co.*, 128 Ariz. 188, 190, 624 P.2d 866, 868 (1981) (citing  
28 *Anderson v. Cont'l Ins. Co.*, 85 Wis. 2d 675, 271 N.W.2d 368 (1978)). That is true



1 “whether the debate concerns a matter of fact or law.” *Anderson*, 85 Wis. 2d at 691, 271  
2 N.W.2d at 376.

3 An insurer who blindly denies coverage is not free of bad faith merely because it  
4 guessed right, without basis, that coverage would be fairly debatable. The insurer must  
5 have genuinely believed at the time of denial that coverage was fairly debatable, and  
6 whether the insurer did so believe is generally an issue of fact. *See Zilisch*, 196 Ariz. at  
7 237, 995 P.2d at 279. But the City has not presented any evidence sufficient to raise a  
8 triable question as to The Hartford’s belief in its coverage position. The Hartford told the  
9 City from the beginning that the City must exhaust the retained limits in each applicable  
10 policy period before accessing coverage for that period. Contrary to the City’s attempted  
11 analogy to *Rowland v. Great States Insurance Co.*, there is no evidence that The Hartford  
12 “consciously and unreasonably disregarded the authority” that the City cited, “failed to  
13 investigate its own position,” or “delayed resolving this dispute,” 199 Ariz. 577, 586, 20  
14 P.3d 1158, 1167 (Ct. App. 2001). All the evidence is exactly the opposite.

15 Thus, there is no evidence that The Hartford acted unreasonably in processing or  
16 denying its claim, much less that it knew or was conscious of such unreasonableness.

## 17 18 **V. EXPERT TESTIMONY**

19 Summary judgment is proper, even if Jeffrey Stempel’s opinion testimony is  
20 admissible. But much of it must be excluded in any event. Stempel is a law professor  
21 who has published books and articles on insurance law. He prepared for the City a thirty-  
22 four-page, single-spaced report “to address insurance issues in this matter.” (Doc. 67-2.)  
23 His report extends far beyond the range of admissible expert opinions.

24 His report consists largely of legal opinions. Some of his opinions are  
25 interpretations of language in The Hartford’s policies, such as the following:

26 The language of the policies sold to the City do not support  
27 the reduction in coverage sought by [The Hartford].

28 . . .



1 The most natural reading of this policy language is that the  
2 most the City will be required to pay in order for First-Layer  
3 coverage to attach is \$500,000.

4 . . .

5 The natural reading of this language is that where a claim is  
6 triggered that implicates the attachment point of the policies,  
7 the umbrella insurer has a duty to defend unless an underlying  
8 insurer . . . is required to defend.

9 (*Id.* at 4, 17, 25.) Some of his opinions are assertions of Arizona insurance law, such as  
10 the following:

11 Although every contract carries with it an obligation of good  
12 faith and fair dealing, the good faith duties surrounding  
13 insurance policies are significantly greater than for most non-  
14 insurance contracts and under Arizona law can support a tort  
15 cause of action for injuries suffered by a policyholder due to  
16 insurer bad faith.

17 . . .

18 Arizona, like most states, follows the rule that where there is  
19 unclear language in a policy, the language is construed  
20 against the insurer that drafted the policy unless the textual  
21 ambiguity can be readily resolved by reference to extrinsic  
22 evidence or context that clarifies the ambiguity.

23 . . .

24 Arizona applies the principle that an insurance policy may not  
25 be interpreted so as to defeat the reasonable expectations of  
26 the insured. All jurisdictions appear to consider the  
27 policyholder's objectively reasonable expectations when  
28 construing ambiguous language. Arizona applies a stronger  
version of the concept than many states, one in which the  
language in the portion of the instrument that the customer is  
not ordinarily expected to read or understand ought not to be  
allowed to contradict the bargain made by the parties.

(*Id.* at 12, 13, 14 (citations and internal quotation marks omitted).) Some of his opinions  
are applications of Arizona law to the facts of this case, such as the following:

1 Under these circumstances, it was wrongful claims handling  
2 by Hartford to act in self-interest in the face of Arizona law  
3 by self-servingly assuming that Arizona law supported  
4 allocation among insurers that forced a policyholder to pay  
multiple [self-insured retentions] . . . .

5 . . .

6 In the absence of any Arizona precedent favoring its position  
7 (and no state Supreme Court decisions on the issue), an  
8 insurer meeting the “equal consideration” standard of care  
9 would resolve the allocation/apportionment conflict in favor  
10 of the policyholder until such time as the insurer could obtain  
a judicial ruling in its favor or at least point to controlling  
favorable and sufficiently analogous precedent. Hartford did  
not do this . . . .

11 . . .

12 For the reasons set forth above, it is my opinion that  
13 Hartford’s conduct toward the City fell below the applicable  
14 standard of care required of insurers acting in good faith  
15 toward policyholders and also violated unfair claims practices  
16 legislation. . . . In addition, in light of Hartford’s slow and  
17 inadequate claims handling response, unreasonable coverage  
18 position, and failure to adequately investigate and consider  
Arizona law, it appears that Hartford acted with willful  
indifference and in conscious disregard of the interests of its  
policyholder and is subject to punitive damages.

19 (*Id.* at 23, 30, 35.)

20 None of this is legitimate expert testimony. Federal Rule of Evidence 702 permits  
21 an expert to testify only if the testimony “will help the trier of fact to understand the  
22 evidence or to determine a fact in issue.” An expert “cannot give an opinion as to her  
23 *legal conclusion*, i.e., an opinion on an ultimate issue of law. Similarly, instructing the  
24 jury on the applicable law is the exclusive province of the court.” *Nationwide Transp.*  
25 *Fin. v. Cass Info. Sys., Inc.*, 523 F.3d 1051, 1058 (9th Cir. 2008). As illustrated above,  
26 much of Stempel’s report invades the province of the court by expounding law or invades  
27 the province of the jury by resolving facts. The material facts on these motions are not in  
28

1 dispute. Some of his opinions are incorrect under Arizona law. Some fail to take account  
2 of undisputed facts or have no basis in the evidence before this Court on summary  
3 judgment.

4 The City attempts to analogize Stempel's report to testimony deemed admissible  
5 in *Hangarter v. Provident Life & Accident Insurance Co.*, 373 F.3d 998, 1016–17 (9th  
6 Cir. 2004). That analogy fails. The expert witness in *Hangarter* merely made passing  
7 “references” to legal provisions and never actually “reached a legal conclusion.” *Id.*  
8 Stempel does not just “refer” to legal provisions; he spends pages detailing insurance law,  
9 complete with case citations. He offers to testify that The Hartford breached the terms of  
10 its policies, acted in bad faith, and deserves punitive damages. None of that is admissible  
11 on this record; indeed, it is all incorrect.

12 Thus, Stempel's report will be excluded to the extent that it asserts legal  
13 principles, reaches legal conclusions, or asserts facts contrary to or unsupported by the  
14 record on these motions. Nothing else in Stempel's report is both admissible and  
15 sufficient to controvert The Hartford's motion for summary judgment.

## 16 17 **VI. MOTION TO TRANSFER**

18 Two months after the City and The Hartford filed their cross-motions for summary  
19 judgment in this case, Berkshire Hathaway Specialty Insurance Company (“Berkshire”)   
20 filed an action before a different judge of this court. *Berkshire Hathaway Specialty Ins.*  
21 *Co. v. City of Phoenix, et al.*, No. 2:16-cv-01083-PHX-JAT. Berkshire's complaint in  
22 that action alleges as follows.

23 Berkshire was one of the City's other insurers during the twenty-six years in  
24 which Carlos Tarazon was exposed to asbestos. It insured the City against excess bodily  
25 injury liability from July 1, 1976 to July 1, 1977. The terms and structure of Berkshire's  
26 policy differed somewhat from The Hartford's policies. For example, Berkshire agreed  
27 to indemnify the City above a \$300,000 self-insured retention, and its basic insuring  
28 clause referred to “all sums” for which the City is liable.

1 During the Tarazon asbestos lawsuit, the City demanded coverage from Berkshire.  
2 However, the City did not give Berkshire information from which it could evaluate  
3 whether the asbestos claim exceeded the City's self-insured retention, despite Berkshire's  
4 requests for information and the City's duty to provide it. Moreover, the City settled the  
5 asbestos claim without Berkshire's knowledge or consent, despite the City's duty to  
6 notify Berkshire of settlement negotiations and obtain its consent for settlement.

7 Shortly after the City settled the Tarazon lawsuit, a second City worker, Francisco  
8 Herrera, sued the City for asbestos-related injury. Once again, Berkshire was one of the  
9 City's insurers during the period of asbestos exposure. As before, the City demanded  
10 coverage from Berkshire, but the City did not adequately respond to Berkshire's requests  
11 for information and other communications. Herrera's action is pending.

12 The City has not sued Berkshire with respect to either the Tarazon action or the  
13 Herrera action. The City has opposed The Hartford's attempt to include Berkshire as a  
14 party in this case. (Docs. 24, 28.) Thus, Berkshire's complaint seeks only declaratory  
15 judgments that (1) the City's failure to cooperate with Berkshire in the Tarazon and  
16 Herrera actions extinguishes any duty to indemnify, (2) the City's failure to notify  
17 Berkshire and obtain its consent as to settlement in the Tarazon action extinguishes any  
18 duty to indemnify, (3) the Tarazon and Herrera actions are separate "occurrences" such  
19 that the City must exhaust its \$300,000 self-insured retention in each action before  
20 coverage can arise, (4) the City's decision to sue The Hartford and not Berkshire means  
21 Berkshire does not owe anything until The Hartford's coverage is exhausted, (5) any  
22 liability covered by Berkshire's policy should be allocated pro rata among all relevant  
23 insurers, and (6) Berkshire is entitled to reimbursement from other insurers in the event it  
24 pays more than its pro rata share of liability. Berkshire's complaint names the City and a  
25 multitude of other insurers, including The Hartford, as defendants.

26 The Hartford moves to transfer Berkshire's case to the undersigned judge. Local  
27 rules provide, in relevant part, that a party may move to transfer a case to a judge with a  
28

1 related case if the cases (1) “arise from substantially the same transaction or event,” (2)  
2 “involve substantially the same parties or property,” (3) “call for determination of  
3 substantially the same questions of law,” or (4) would “entail substantial duplication of  
4 labor if heard by different Judges.” LRCiv 42.1(a). A principal factor is whether party  
5 economy or judicial economy is substantially served by transfer to another judge.

6 Although Berkshire’s case involves some of the parties and transactions involved  
7 in this case, there are substantial differences. Berkshire itself is not a party in this case,  
8 nor are any of the other insurers except The Hartford. Some of Berkshire’s claims  
9 involve its duty to indemnify the City for the Tarazon claim and defense, as does this  
10 action against The Hartford. But the transactions between the City and The Hartford  
11 were different from the transactions between the City and the other insurers. The arrays  
12 of coverage varied from year to year. Berkshire and the other carriers insured the City  
13 under different policy language. The City’s communications with Berkshire were sparser  
14 than its communications with The Hartford. The Herrera claim arises from different  
15 facts. Most of the legal questions Berkshire attempts to raise were not raised in this case.  
16 The questions decided in this order generally could not arise in Berkshire’s case unless  
17 earlier questions are resolved against Berkshire.

18 At the outset, Berkshire’s case raises serious questions of ripeness and the need for  
19 declaratory judgment, given that the City has not sued Berkshire and may never do so. If  
20 the rulings in this order are correct, there will be no reason for the City to sue Berkshire  
21 on the Tarazon claim because Berkshire’s one twenty-sixth share of the City’s total  
22 indemnity and defense costs is under \$80,000, far less than Berkshire’s \$300,000 self-  
23 insured retention. Though the City’s expenses on the Herrera action cannot be known  
24 until the action is concluded, it is similarly unlikely that those expenses will be high  
25 enough to exhaust the retention. The City and some of the insurer-defendants have  
26 moved to dismiss Berkshire’s case on some of those grounds.

1 Finally, declining to transfer Berkshire's case would not create any substantial  
2 duplication of labor. The parties in this case cross-moved for summary judgment two  
3 months before Berkshire's case was even filed, and those motions have now been decided  
4 in a case-dispositive way. The only remaining questions are in Berkshire's case. Only  
5 one judge will work on those questions, whether or not the case is transferred. The  
6 motion to transfer will be denied, leaving Berkshire's case in capable hands.

7  
8 IT IS THEREFORE ORDERED that Defendants' Motion for Summary Judgment  
9 (Doc. 65) is granted.

10 IT IS FURTHER ORDERED that the City's Motion for Partial Summary  
11 Judgment (Doc. 68) is denied.

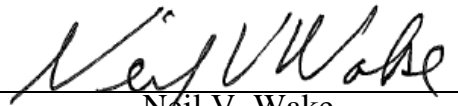
12 IT IS FURTHER ORDERED that Defendants' Motion to Exclude Expert  
13 Testimony of Jeffrey Stempel (Doc. 67) is granted to the extent stated in this order.

14 IT IS FURTHER ORDERED that Defendants' Motion to Transfer Related Case  
15 (Doc. 78) is denied.

16 IT IS FURTHER ORDERED that the Clerk enter judgment against Plaintiff City  
17 of Phoenix and in favor of Defendants First State Insurance Company, Twin City Fire  
18 Insurance Company, New England Reinsurance Corporation, and Nutmeg Insurance  
19 Company that Plaintiff take nothing.

20 The Clerk shall terminate this case.

21 Dated this 2nd day of September, 2016.

22  
23   
24 Neil V. Wake  
25 Senior United States District  
26 Judge  
27  
28